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Board
[Annual] Report to the Minister
of Finance.
1939-1945



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Canada.
FOREIGN EXCHANGE
CONTROL BOARD



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REPORT TO THE MINISTER OF FINANCE

[1939 — 1945]

OTTAWA, MARCH, 1946



Foreign Exchange Control Board

Ottawa

March 1, 1946.

The Rt. Hon. J. L. Ilesley,
Minister of Finance,
OTTAWA.

Dear Sir,

I have the honour to transmit herewith a report of the Foreign Exchange Control Board covering the main aspects of the Board's operations to the end of 1945. There is included in this report certain background information as well as a review of exchange policies and the administration of foreign exchange control during the war period.

Yours faithfully,

G. F. TOWERS,

Chairman.

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REPORT OF THE FOREIGN EXCHANGE CONTROL BOARD TO THE MINISTER OF FINANCE

I. SUMMARY OF BASIC FACTORS IN CANADA'S EXCHANGE POSITION

It is convenient to begin this report on the wartime system of exchange control and wartime exchange policies with a brief summary of some of the basic factors affecting the Canadian exchange position. These basic factors constitute the main explanation of the necessity for the adoption of exchange control in September 1939 and they form a vital element in the appraisal of future exchange policy.

One of the most characteristic elements in the Canadian balance of international payments in the past has been its instability from year to year; this instability is illustrated below in a brief review of the major changes which took place in our balance of payments as a whole in the course of the past generation. The geographical structure of our balance of payments and the international debtor status of Canada are the other basic factors in our exchange position, and they too are outlined briefly.

(a) *Review of Major Changes in the Balance of Payments as a Whole*

Before the war of 1914-18, during the period of rapid economic development and expansion, Canada was an importer of capital on a large scale. The total excess of imports over exports during the five years 1910 to 1914 was \$950 million. Other international payments on current account exceeded receipts by \$750 million. The aggregate deficiency on current account, and therefore the apparent capital import or net increase in external debt, was accordingly some \$1,700 million during those five years.

In the course of the war of 1914-18, production of munitions and other exportable goods increased rapidly, and prices rose to

much higher levels. Exports far exceeded imports, but the "invisible" current account transactions resulted in a large deficit.

After the war, greatly expanded domestic incomes caused a rapid increase in imports. In the early 'twenties there were once more substantial deficits in Canada's international current account. In 1920 alone the deficit was \$350 million, an abrupt and very large change from the previous year's small surplus on current account. These deficits were met by large borrowings in the United States which replaced the United Kingdom as Canada's chief external source of capital.

The middle 'twenties saw Canada attain the status of what is known as a mature debtor nation. The production made possible in part by earlier capital imports was sold at relatively high prices in world markets, and produced a surplus on current account which was used to add to Canada's foreign assets.

This situation changed once more with great abruptness with the collapse of export prices in 1929 and subsequent years, and the reduction in the physical volume of exports. The demand for imports had been growing rapidly under the stimulus of domestic prosperity and extensive investment, much of which was financed by capital imports. The demand for luxuries and consumers' durable goods and for producers' equipment and materials is sensitive to changes in income, and since these commodities bulk large in Canada's imports, fluctuations of domestic prosperity in Canada result in very large fluctuations in imports. At the same time, our exports are largely staple products which are subject to wide fluctuations in world prices. The changes in exports do not coincide in point of time or magnitude with the changes in imports and there is thus a tendency to rapid and large fluctuations in the net balance of trade, i.e. the excess or deficiency of exports as compared with imports. In the three years 1929-31 we had a net trade deficit of \$165 million, compared with a net surplus of \$590 million in the three preceding years 1926-28. By this time payment of interest and dividends on foreign investments in Canada had become a large and fairly rigid feature of the current account and the current account as a whole showed a deficit of \$825 million in 1929-31 compared with a surplus of \$85 million in 1926-28.

By the mid-thirties, the effect of low export prices for natural products and industrial unemployment had been so to reduce the demand for the kind of goods that are chiefly imported that the current account was approximately in balance, at a low level of both receipts and payments. During the late 'thirties both exports and imports expanded; with the rapid increase in gold production, Canada became a capital exporter, i.e. net external debt was reduced at the rate of about \$150 million a year. The total surplus on current account was \$775 million in the five years 1935-39.

Table I below shows the changes during the period 1926-39 in the current account balance of payments. It illustrates the variability of Canada's current account balance of payments, and its sensitivity to changes in foreign demand and in domestic prosperity.

TABLE I

*Canada's Receipts from and Payments for (-) Exports, Imports and other Current Account Items, 1926-39**

(Annual averages in millions of dollars)

	Exports	Imports	Net trade balance	All other items	Newly mined gold	Total Current Account
1926-28.....	1,275	-1,080	195	-200	35	30
1929-31.....	885	-940	-55	-265	45	-275
1932-34.....	560	-415	145	-245	90	-10
1935-37.....	905	-640	265	-220	135	180
1938-39.....	875	-680	195	-255	175	115

*Source: Dominion Bureau of Statistics

(b) *Geographical Distribution of Net Credits and Debits on Current Account*

Reliable statistics on the geographical distribution of our trade and other elements in the balance of payments are available only for the years after 1925. From 1926 to 1939 the main features are (1) a persistent deficit in our transactions with the United States, and (2) a marked shift from continental Europe to the United Kingdom as the chief source of a surplus of foreign exchange receipts with which to offset a chronic deficiency of United States dollars.

Our surplus with continental Europe was largely dependent on heavy wheat and flour exports. To all destinations, these averaged \$435 million in 1926-28 but they declined to small proportions in the early 'thirties and did not recover, averaging \$155 million from 1935 to 1939. In the case of the United Kingdom, however, increased exports of lumber and minerals in the late 'thirties more than took the place of wheat, and for the first time the Canadian balance of payments showed a substantial surplus on current account with the United Kingdom.

The foregoing features are illustrated in Table II below.

TABLE II
*Canada's Net Current Account Balances with U.S.A., Europe
and U.K., 1926-1939**

(Annual averages in millions of dollars)

	U.S.A. (excluding gold)	U.S.A. (including gold)	Continental Europe	U.K.
1926-28.....	-310	-275	205	5
1929-31.....	-375	-330	65	-85
1932-34.....	-210	-120	40	20
1935-37.....	-170	- 35	35	105
1938-39.....	-305	-130	20	130

*Source: Dominion Bureau of Statistics

The onset of war crystallized a development which is implicit in the foregoing figures, namely that from Canada's point of view the rest of the world has in recent years been divided into two areas—the sterling area and the dollar area—and that accordingly Canada's interest is greatly bound up in the maintenance of a multilateral system in which a surplus of one of the major foreign currencies may be used to offset a deficiency of the other.

(c) *International Debtor Position*

The main phases in Canadian borrowing abroad have been indicated above. The large external borrowings which took place before the war of 1914-18 were mainly from the United Kingdom. After the war, only occasional loans were floated in that country and sterling issues of Canadian debtors were repatriated

in substantial amounts in periods when sterling stood at a discount in terms of Canadian funds, such as 1919 to 1924 and 1931 and 1932. The bulk of the fresh borrowing was done in the United States. Borrowing was heavy in the 1920's; in certain years, however, Canadians were net purchasers of American securities and there were net retirements of Canadian obligations held in the United States in the latter 1930's. The aggregate foreign investment in Canada at the outbreak of war in 1939 was nearly \$7,000 million, more than half of which, as Table III below shows, was held by American investors. The figures in this table are based on book values and cover investments in branch plants and subsidiary companies as well as portfolio securities.

TABLE III
*Foreign Investment in Canada, 1939**
(in millions of dollars)

	U.S.A.	U.K.†	All other countries‡	Total
Government Securities.....	1,241	408‡	23	1,672
Public Utilities.....	1,059	1,340	95	2,494
Industrial and commercial.....	1,604	377	51	2,032
Financial institutions.....	201	221	51	473
Miscellaneous assets.....	85	120	50	255
Total.....	4,190	2,466	270	6,926

*Source: Dominion Bureau of Statistics.

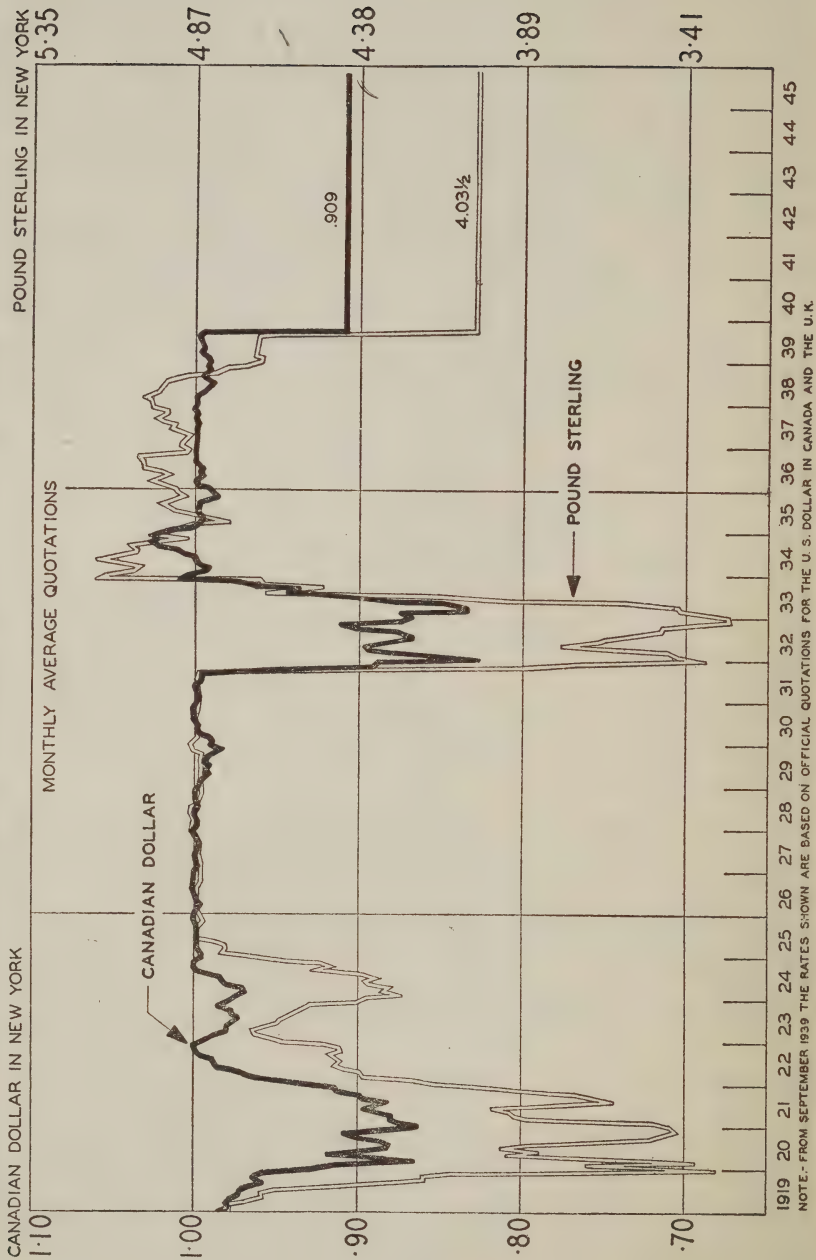
†An unascertainable amount of investment beneficially owned in countries other than the United Kingdom was held by U.K. nominees and hence appears in the U.K. column.

‡After repatriation of \$75 mm. in latter months of 1939.

(d) *Movements of the Canadian Exchange Rate*

The diagram on page 8 shows that in the majority of years between 1919 and 1939 the Canadian dollar exchange rate fluctuated rather widely. It also illustrates the tendency of the Canadian dollar, in periods when sterling is depreciated to be quoted at a level of depreciation approximately half that prevailing for sterling.

CANADIAN DOLLAR AND POUND STERLING IN NEW YORK : 1919 - 45



II. EXCHANGE CONTROL POLICIES AND METHODS

(a) *Reasons for the Establishment of Exchange Control*

The essential reasons for the establishment of exchange control in Canada in September 1939 are implied in the preceding analysis of the basic long-run factors affecting the Canadian exchange position. The purpose of exchange control was to maintain exchange stability and to conserve Canada's supply of United States dollars for essential war and civilian requirements by ensuring that it was not dissipated on non-essential purposes such as capital export.

As regards capital export, the main preoccupation was, of course, with the large American investment in Canada. It was expected that some non-resident holders of Canadian securities would not wish to keep their money invested in a belligerent country but would sell their securities on the Canadian market and withdraw the proceeds in foreign exchange. This would have used up Canada's supply of United States dollars and rendered more difficult an orderly programme of war financing. In considering why exchange control was necessary in 1939 but not in 1914 it is, of course, necessary to bear in mind the changed character of the foreign investment in Canada. At the earlier period Canada's principal foreign creditor was the United Kingdom and a large part of her investment in Canada was not readily marketable here as it took the form either of sterling issues of Canadian debtors or direct investments in branch plants. The United Kingdom at this time had large reserves of United States dollars, and throughout the first world war was able to maintain both stable exchange rates and the convertibility of sterling without exchange control. In the early part of the war, the United Kingdom provided United States dollars in settlement of Canada's surplus exports to the United Kingdom, and in the latter part of the war Canada borrowed in the United States. Moreover, in 1914 international capital was much less sensitive and did not flow so readily from one country to another in search of refuge at the first hint of trouble, as was the case in the 1930's.

Apart from the danger of capital withdrawal and capital flight in 1939, it was anticipated that our current account transactions with the United States would result in a large deficit. It has been shown in the preceding chapter that even before the

war Canada ran a deficit with the United States. This was bound to increase as a result of the war. By contrast with 1914-1918, when Canada's economic contribution consisted mainly of the natural products of the country, we were setting out in 1939 to produce many types of mechanical equipment, most of them requiring substantial imports from the United States. In addition to the abnormal imports of parts and components of war goods, it had also to be anticipated that ordinary civilian imports from the United States would rise as domestic supplies of similar goods would not be available in sufficient volume if a large part of the Canadian economy were devoted to war production.

It was also expected, of course, that Canada's current account balance with the United Kingdom would increase as we became a major source of supply of war and civilian goods. But it could no longer be expected that surplus sterling accruing to our credit could be converted into United States funds: the United Kingdom, having relatively small reserves of United States dollars and anticipating a deficiency, had established exchange control at the outbreak of war and sterling had ceased to be convertible. The structural characteristic of the Canadian current account balance of payments illustrated in the preceding chapter—the deficiency of United States dollars and the surplus of sterling—which was of no particular importance from a foreign exchange point of view before the war, came to be of great importance with the outbreak of war. Unusually heavy requirements of United States exchange would have to be met at a time when one of the most important methods previously used for covering such demands, namely the automatic conversion of surplus sterling, ceased to be available.

In these circumstances there were no grounds for believing that, without foreign exchange control, there would be enough United States exchange to satisfy all demands, and exchange control was therefore adopted as the method of ensuring that essential demands were given priority over non-essential and that disturbing fluctuations in exchange rates were eliminated.

(b) *General Description of the Powers of the Board*

Foreign exchange control was instituted on September 16, 1939, by the Foreign Exchange Control Order which was passed

by the Governor in Council under the authority of the War Measures Act. The Order established the Foreign Exchange Control Board¹ as the administrative body to carry out the provisions of the Order. The Bank of Canada is technical advisor to the Board and acts as its agent and banker. All branches of Canadian chartered banks are authorized dealers and agents of the Board to buy and sell foreign exchange for the Board's account and otherwise to act on behalf of the Board. The Post Office is agent of the Board with limited authority to sell foreign exchange in the form of Post Office money orders and Postmasters and Collectors of Customs are agents of the Board for the purpose of ensuring that exports and imports conform with the necessary regulations regarding payment. The Board's main offices are in Ottawa and branch offices are maintained in Montreal, Toronto, Windsor and Vancouver.

The Foreign Exchange Control Order in effect places all transactions having international financial implications under the supervision and control of the Board, the principal specific provisions of the Order being as follows:

1. All foreign exchange received by residents of Canada must be sold to an authorized dealer. In addition, on April 30, 1940, the Foreign Exchange Acquisition Order was passed requiring all residents of Canada to sell to the Board all foreign exchange in their possession, ownership or control on that date.
2. Residents of Canada must apply to an authorized dealer or other agent of the Board to obtain all foreign exchange which they require.
3. Transfers of Canadian dollars by residents of Canada to non-residents may be made only under permit.
4. Sales, assignments or transfers of securities by residents to non-residents may be made only under permit.
5. Sales of securities in Canada by or on behalf of non-residents may be made only under permit.

¹The present members of the Board are: G. F. Towers, Governor of the Bank of Canada, who is Chairman; W. C. Clark, Deputy Minister of Finance; N. A. Robertson, Under-Secretary of State for External Affairs; D. Sim, Deputy Minister of National Revenue, Customs and Excise; M. W. Mackenzie, Deputy Minister of Trade and Commerce; H. D. Scully, Canadian Consul General in New York; and H. Beaulieu, Director, Administrative Services, Post Office Department.

6. Exports from and imports into Canada of goods, securities, currency and other property may be made only under permit.

The Order authorizes the Board to pass regulations and issue instructions establishing rules and procedures necessary for carrying out the provisions of the Order. It also authorizes the Board to exempt transactions from the provisions of the Order and a number of types of transactions with the sterling area and other normal small transactions have been exempted by regulation from licence and permit requirements.

The Order authorizes the Board, subject to instructions of the Minister of Finance, to establish rates of exchange at which all foreign exchange transactions in Canada are to be made. Rates for United States dollars and pounds sterling are established for spot transactions as follows:

United States dollars—	Buying—10% premium
	Selling—10½% premium
Pounds sterling	—Buying—4.43
	Selling—4.45

These buying rates have remained unchanged since they were originally established on September 16, 1939. The selling rates were established at these levels on October 15, 1945, having previously been 11% premium for United States dollars and \$4.47 for pounds sterling.

(c) *Necessity of Comprehensive Control*

While the Foreign Exchange Control Order confers on the Board jurisdiction with respect to all transactions having international financial implications, the only restrictive use (apart from the restrictions on the expenditure of United States funds for pleasure travel announced by the Government in July 1940) which has in fact been made of the powers of the Board has been in relation to capital movements.

The reason why the powers of the Board need be as comprehensive as those set out in the preceding section and, in particular, why all transactions, and not merely capital transactions, have to be brought under the supervision of the Board is, in general terms, that in order to control capital transfers effectively it is necessary to scrutinize all transactions involving

the transfer of funds or other property from residents to non-residents. A transaction which appears at first sight to be of a current account nature may involve an export of capital: for example if the foreign exchange proceeds of exports are not repatriated but invested abroad, or if foreign exchange purchased allegedly for imports is used to acquire foreign securities. The licensing of exports and imports is necessary to safeguard against transactions of this type.

The requirement that all foreign exchange received by residents of Canada must be sold to an authorized dealer is necessary to prevent capital export in the form of unauthorized accumulation of foreign currency balances and to ensure that the foreign exchange currently accruing to the Canadian economy through exports of goods, services and securities is placed at the disposal of Canada as a whole by being brought into official reserves. The requirement that all foreign exchange required by residents of Canada must be obtained from an official authorized dealer is a necessary corollary of the requirement that foreign exchange receipts be sold to an authorized dealer. In practice, the Foreign Exchange Control Board has authorized firms having a large number of foreign exchange transactions to operate foreign currency bank accounts in which they may retain working balances; regular reports of transactions passing through these accounts are obtained by the Board.

The transfer of Canadian dollars from resident to non-resident is also brought under control as such transfers involve increased liabilities to non-residents and hence a potential drain on Canada's foreign exchange resources. The non-resident receiving the Canadian dollars will wish to obtain value for them: even if the Canadian dollars are spent in Canada, the Canadian economy will be deprived of receipts of foreign exchange which it would otherwise have obtained.

There is a further reason of a somewhat different character why exchange control has to extend to all transactions even though restrictions are applied only to certain types of capital transaction. Our transactions with the outside world fall into two groups, those with the sterling area and those with the United States and other countries not forming part of the sterling area. Our transactions with the second group are conducted in terms

of United States dollars while our transactions with the first group are conducted in terms of sterling. As we tend to have a surplus of sterling and a shortage of United States funds in our current transactions with these two groups and as, under present conditions, sterling is not freely convertible into United States funds, it is in our interest to ensure that the proper kinds of currency are used in our international transactions and that we do not, for example, pay United States dollars for imports originating in the sterling area or receive sterling for our exports to the non-sterling area. The comprehensive machinery of exchange control enables us to co-operate with the sterling area exchange control authorities for the above purpose.

(d) *Summary of Policies Governing Transactions with the United States Dollar Area*

The underlying basis of exchange control vis-a-vis the United States dollar area is to prevent the direct or indirect use of Canada's United States dollar resources for unnecessary exports of capital to that area while making United States dollars available for all normal current account payments and for maturing capital obligations expressed in United States dollars. Exports from, and services rendered by, Canada to the United States dollar area are required to produce United States dollars which will be made available to the Board. Similarly, Canadian residents receiving income or capital payments in United States dollars are obliged to account to the Board for them.

EXPORTS

Exports of goods are Canada's largest source of United States dollars and the function of exchange control is to ensure that all such exports actually result in their value in United States dollars being placed at the disposal of the Board within a reasonable time. The Board's export licence form is combined with the usual Customs export entry form and calls for a declaration by the exporter describing the goods, their destination, the amount and currency of payment to be received, the date on which payment is expected and the name of the bank through which the exchange will be sold to the Board. The form accompanies the goods to the port of exit and may be approved by a Customs Officer on behalf of the Board where payment of the value of the goods is

to be received in United States dollars within six months. Copies of the form are sent to the exporter's bank and to the Board where they are matched against the form covering the sale to the bank of the United States dollars received for the export. Customs Officers also have certain authority to approve exports for no payment, e.g. in the case of goods of no commercial value. In other cases the approval of the licence by an authorized dealer or the Board is necessary in order to ensure that no export of capital is taking place. The Board does not exercise any control over the kinds of goods which may be exported and is concerned in its licensing of exports only with the manner and terms of payment.

IMPORTS

United States dollars are made available for payment of any goods originating in the United States dollar area which are legally imported into Canada and the Board exercises no control over the kinds of goods which may be imported. Its function is to ensure that when United States dollars are supplied to pay for imports, goods of equivalent value have entered or will enter Canada within a reasonable time and that such goods did not originate in the sterling area in which case they could be paid for in sterling or Canadian dollars rather than in United States dollars. The Board's import licence form is completed as one of a set of the usual Customs import entry forms and shows the value and country of origin of the goods. The licence is approved by Customs on behalf of the Board at the time the goods are entered through Customs. The licence then serves as evidence which the importer may produce to his bank when he wishes to purchase United States dollars to pay for the goods and is matched by the bank against the permit form covering the sale of the exchange.

OTHER CURRENT PAYMENTS

United States dollars are made available for the fair value of all normal services rendered to Canadian residents by residents of the United States dollar area and for the payment of current income of all kinds such as rents, interest, dividends, wages, etc. due by Canadian residents to residents of the United States dollar area. Even in cases where such income is contractually payable only in Canadian dollars, either the resident making the payment

or the non-resident may obtain United States dollars at the official rate for the equivalent of the Canadian dollar amount payable. Payments of dividends by Canadian companies having shareholders who are residents of the United States dollar area are normally limited to the amount of the earnings of the company since the commencement of exchange control, any accumulated earnings as of that date being regarded as having assumed the character of capital invested in Canada. Interest on publicly issued bonds or debentures of Canadian debtors are approved, however, whether or not they are covered by current earnings.

Bona fide benevolent remittances to the United States dollar area such as charitable donations, gifts, family maintenance, religious and missionary expenditures and remittances by non-profit organizations are permitted within moderate limits and United States dollars are provided for these purposes.

CAPITAL OBLIGATIONS

Since the adoption of exchange control, the payment of capital obligations to non-residents has been authorized, when due, in Canadian dollars or foreign exchange as called for in the contract giving rise to the payment. In addition, as a partial offset to the inflow of capital in recent years, the Board has sold United States dollars or permitted Canadian dollars to be transferred to non-residents in connection with certain additional classes of capital payments. Thus, where Canadian debtors have the opportunity of refunding United States dollar obligations at lower interest rates in advance of maturity and wish at the same time to retire a certain part of their debt, United States dollars are now ordinarily provided.

PROTECTION OF EXISTING INVESTMENTS AND NEW CAPITAL INVESTMENTS

United States dollars are made available to residents for capital purposes when they are required to protect an existing investment in the United States dollar area. Since the early part of 1944, United States dollars have also been provided to Canadian residents for capital investment in new commercial ventures in the United States dollar area meeting certain requirements, e.g. that they can reasonably be expected to provide export outlets

for Canadian goods or sources of supply for Canadian industry or where the new venture is complementary to operations already carried on by the applicant in Canada.

OTHER CAPITAL PAYMENTS

There are certain types of capital payments for which United States dollars are not provided out of official reserves at the official rate but for which payment is permitted in Canadian dollars which the recipient may convert into United States funds by sale to another non-resident in the free exchange market outside Canada. These include payment at maturity of Canadian dollar obligations held by non-residents, payment of the purchase price of real estate in Canada sold by a non-resident to a resident, the proceeds of liquidations of businesses in Canada owned by non-residents and the settlement of capital amounts due by Canadian companies to parent or related companies in the United States dollar area. Permission is also given for the payment in Canadian dollars of legacies and other capital payments due from Canadian estates to beneficiaries who are residents in the United States dollar area. Prior to the early part of 1943 payments of these types were ordinarily permitted only on condition that the non-resident retained his capital investment in Canada by reinvesting in Canadian domestic securities. The payments mentioned in this paragraph, taken in conjunction with the Canadian dollar deposits held by non-residents at the inception of exchange control, constitute the main source of supply of Canadian dollars to the unofficial exchange market.

SECURITIES TRANSACTIONS

The commonest and most direct form of export of capital is represented by the purchase of securities by residents from non-residents. The basic principles of foreign exchange control are that Canada's United States dollar resources may not be used by residents to increase their investments in foreign securities above the amount of such investments at the commencement of exchange control and that they may not be used by residents of the United States dollar area to reduce their investments in Canadian securities below the amount of such investments at the beginning of control.

Residents are granted the necessary permits to sell and transfer Canadian or foreign securities to non-residents provided they receive immediate payment of the value of the securities. If Canadian domestic securities are sold, payment may be obtained in Canadian dollars from the non-resident. In other cases payment must be obtained in United States dollars which are either made available to the Board or are reinvested in other marketable securities payable in United States dollars. Prior to February 1945, it was a requirement that the sale and reinvestment be made simultaneously but since that time provision has been made whereby the proceeds of sales may be held for a reasonable time by a broker or dealer pending reinvestment. In order to ensure that these conditions are met, permits are required for the physical export of securities from Canada as well as for sales, transfers or assignments of securities by residents to non-residents, the same permit form serving both purposes.

Permits for sales in Canada of securities held by residents of the United States dollar area are not ordinarily granted unless the non-resident is reinvesting the proceeds in other domestic securities or unless the securities were purchased outright in Canada by the non-resident subsequent to the commencement of exchange control and the purchase was registered with the Board. Until January 1946, non-residents who wished to make fresh investments in Canadian domestic securities might register such purchases with the Board and permission is normally granted for the subsequent outright sale of such securities and the withdrawal of the proceeds from Canada in Canadian dollars which the non-resident is free to dispose of in exchange markets outside Canada. Since January 1946, however, the Board has not accepted registrations for subsequent sale of non-resident purchases of Canadian bonds and debentures as distinct from stocks and shares. Up to the end of 1945 non-resident purchases of securities totalling \$432 million had been registered with the Board and sales aggregated \$44 million.

TRAVEL

Since May 1945, United States dollars have been made available to Canadian residents for any reasonable expenditures in connection with travel in countries in the United States dollar area. A permit is required for a resident traveller to export from

Canada funds in the form of Canadian or United States dollar cash and travellers' cheques with a combined total of more than \$50 in order to ensure that any United States dollars in the traveller's possession were legally acquired from an authorized dealer and that funds are not being exported under the guise of travel funds for use for an unauthorized purpose.

(e) *Summary of Policies Governing Transactions with the Sterling Area*

Transactions between Canada and the sterling area¹ are carried out in either sterling or Canadian dollars. As the problem is the sterling area's shortage of Canadian dollars, there are no restrictions on or permit requirements for payments from Canada to the sterling area in either Canadian dollars or sterling and no import licence is required for goods of sterling area origin. Exports to the sterling area are permitted whether or not payment is to be received and Canadian residents are not required to sell to the Board sterling which comes into their possession. While permits are required for sales of securities in Canada by sterling area residents, such permits are readily granted where the Canadian dollar proceeds are to be made available to a sterling area exchange control. Payments from the sterling area to Canada are controlled by the sterling area exchange control authorities who do not, in general, permit payments of a capital nature.

III. SURVEY OF U.S. DOLLAR POSITION AND POLICIES 1939-45

(a) *Summary of Period as a Whole*

Taking the period September 15, 1939 to December 31, 1945 as a whole, Canada substantially increased her liquid balances in the form of gold and United States funds, but at the cost of reductions in other assets and increases in liabilities. Table IV below shows these balances at the date of establishment of exchange control and at the end of each subsequent year.

¹The sterling area comprises the British Commonwealth and Empire (except Canada and Newfoundland) and Egypt, Anglo-Egyptian Sudan, Iceland, Faroe Islands and Iraq.

TABLE IV
Canada's Holdings of Gold and U.S. Dollars
(in millions of U.S. dollars)

	F.E.C.B. (and Bank of Canada)	Dominion Government	Private*	Total
Sept. 15, 1939.....	238.7	22.4	132	393.1
Dec. 31, 1939.....	272.8	33.4	98	404.2
Dec. 31, 1940.....	309.3	20.8	2	332.1
Dec. 31, 1941.....	164.1	23.5	—	187.6
Dec. 31, 1942.....	242.9	75.6	—	318.5
Dec. 31, 1943.....	373.2	76.4	—	649.6
Dec. 31, 1944.....	800.1	102.1	—	902.2
Dec. 31, 1945.....	1,275.9	232.1	—	1,508.0

*Exclusive of working balances

Notwithstanding the rise in our liquid reserves, our balance of indebtedness vis-a-vis the United States dollar area was substantially the same at the end of 1945 as at the outbreak of war. Table III above shows that at the outbreak of the war, United States investments in Canada, including investment in branches and subsidiaries as well as portfolio holdings of Canadian securities, amounted to approximately \$4,200 million. Taking into account assets in the United States held by Canadians, Canada's balance of indebtedness to the United States was in the neighborhood of \$3 billion.

Table V summarizes by years the changes in the main categories of our United States dollar assets and liabilities since 1939.* It will be noted that while our liquid reserves of gold and United States dollars increased materially over the period September 15, 1939 - December 31, 1945, there were substantial reductions in Canada's holdings of United States securities and other assets during this period. The increase in our total United States dollar assets (\$747 million) was of just about the same magnitude as the increase in our external liabilities (\$735 million). The increased liabilities resulted mainly from sales of Canadian

*It should be noted that while the table covers the main items affecting Canada's debtor position vis-a-vis the United States, certain items are omitted because accurate information regarding their magnitude is not available. The omissions relate mainly to accounts payable and receivable. The inclusion of these figures would, however, not significantly affect the figures in the table but it would probably have the result of converting the slight improvement shown in our over-all balance of indebtedness during the period 1939-1945 into a slight deterioration.

TABLE V
Principal Warime Changes in Canada's Debtor Position Vis-a-Vis the United States Dollar
Area to the end of 1945
(Millions of U.S. \$)

	Sept. 16 to Dec. 31, 1939	1940	1941	1942	1943	1944	1945	Total to end of 1945
A. Increases in Canada's External Assets:								
Increase (or decrease-) in liquid reserves in gold or U.S. \$.....	11	-72	-145	131	331	253	606	1,115
Less,—								
U.S. Securities sold or matured.....	12	24	24	21	36	38	81	236
Other Foreign Assets realized.....	2	13	19	17	22	36	23	132
Total Increase in External Assets.....	- 3	-109	-188	93	273	179	502	747
B. Increases in Canada's External Liabilities:								
United States holdings of								
Canadian Securities.....	4	-13	12	97	84	99	201	484
Other Canadian borrowing.....	-9	-42	3	12	17	10	30	21
Undistributed Profits of Branches and Subsidiaries of U. S. Companies in Canada.....	44	16	38	36	23	29	44	230
Total Increase in External Liabilities.....	39	-39	53	145	124	138	275	735
Net Increase in Indebtedness indicated by above changes in position (B-A).....	42	70	241	52	-149	-41	-227	-12

securities to the United States and from the retention in Canada of a substantial part of the earnings of subsidiaries of United States companies, which are eligible for conversion into United States funds through the Foreign Exchange Control Board. It is thus apparent that to a very considerable extent the increase which took place in Canada's reserves of gold and United States dollars from the outbreak of war until the end of 1945 can be ascribed to the liquidation by Canadians of earning assets such as United States securities and the purchase of Canadian securities by American investors.

Table V shows the wide fluctuations which took place in Canada's international debtor position vis-a-vis the United States in the course of the war and it demonstrates the need for ample exchange reserves to protect an economy like that of Canada from instability resulting from fluctuations in its balance of international payments. In the 2½ years from the outbreak of war until the end of 1941, Canada's net debtor position in relation to the United States dollar area worsened by over \$350 million (including a decline of over \$200 million in liquid balances). The entry of the United States into the war at the end of 1941 was accompanied by large expenditures by the United States abroad, including Canada, for war purposes. In 1942 Canadian receipts of United States dollars from this source were, however, not sufficient to offset the continued deficit and our over-all position deteriorated by a further \$52 million, bringing the total deterioration since the outbreak of war to an amount over \$400 million. In the subsequent years the special American war expenditures in Canada, combined with other unusual factors, e.g. very large sales of grain to the United States, helped to enable Canada to recapture the ground lost in the first years of the war and to re-establish her over-all position. Attention should, however, be particularly directed to the fact that the main factors responsible for this result were directly connected with the war and have now ceased to operate.

The fact that Canada's balance of indebtedness to the United States was not higher at the end of 1945 than at the outbreak of war may be considered remarkable when regard is had to the enormous scale of our wartime expenditures in that country. The adjusted figures of our merchandise imports from the United

States, which ran at \$400-\$500 million per year before the war, rose to a level exceeding \$1,300 million in 1943. Over the 6 years 1940-45, merchandise imports from the United States exceeded \$6,000 million. The United States dollars sold to us by the United Kingdom in partial settlement of their deficit with us, and the United States dollars we earned through current transactions with non-sterling area countries other than the United States, were the important factors which prevented the very large cumulative deficit in our current account with the United States during the war years from resulting in an equivalent increase in our balance of indebtedness to that country.

(b) *Summary of the Main Factors Influencing Exchange Position*

The over-all result described in the preceding section reflected various economic developments in Canada and abroad, the more important of which are noted below.

RELATIVE STABILITY DURING THE OPENING MONTHS OF CONTROL

Canada's liquid reserves remained relatively stable in the early months of the war. The introduction of exchange control prevented a flight of capital from Canada and the current account with the United States was not as far out of balance as in later months when Canadian war expenditures in the United States expanded sharply. This period of relative stability continued until the summer of 1940.

RAPID EXCHANGE LOSS, 1940-41

By the early summer of 1940 it became evident that the stability would be short-lived. The course of the war following the German offensive and occupation of France and other Allied nations in Western Europe led to a great expansion in the Canadian programme of war production, both for Canadian account and for British account, and gave rise to heavy requirements of United States dollars to purchase the machine tools, other capital equipment, aircraft and military equipment, and materials and components needed for this programme. These could only be obtained in the United States. The heavy wartime demands were additional to the large civilian demands for imports which were themselves augmented as a result of the increase in incomes in Canada. Imports from the United States

rose throughout 1940 and by 1941 reached a level more than twice as high as in 1938.⁽¹⁾

During the same period Canada's current income in United States dollars was rising only moderately. Commodity exports to the United States increased, as did gold production, but there was a shrinkage in American tourists' expenditures in Canada in 1940 and, with the over-running of Europe, a sharp falling off in the important revenue from exports to other foreign countries.

In these circumstances the current account deficit between Canada and the United States dollar countries rose rapidly: the current deficit with the United States rose from \$116 million in 1939 to \$292 million in 1940 and \$318 million in 1941; the current account surplus with other non-Empire countries was reduced from \$78 million in 1938 to \$22 million in 1940 and \$4 million in 1941. Our liquid reserves fell sharply. During the period of most rapid decline, from March 1940 to the end of January 1942, there was a loss of \$210 million U.S. in reserves, and this notwithstanding special receipts of \$225 million U.S. from the United Kingdom in partial settlement of the British deficit of Canadian dollars. At the end of January 1942, Canada's liquid reserves of gold and United States dollars were down to \$174 million U.S., having declined by \$85 million U.S. in the preceding four months.

MEASURES OF EXCHANGE MOBILIZATION AND CONSERVATION

Various official measures were adopted during this period of rapid exchange loss to mobilize and conserve the diminishing supply of foreign exchange for the more essential purposes of the war. The Foreign Exchange Acquisition Order of April 30, 1940 required residents of Canada to sell foreign currency owned by them to the Foreign Exchange Control Board. Under this measure, \$24.8 million in United States funds was transferred from the Bank of Canada to the Foreign Exchange Control Board and \$57.5 million from private holders. By a separate order the gold holdings of the Bank of Canada, amounting to \$205.2 million U.S., were also transferred.

In the budget of June, 1940, the War Exchange Tax of 10 per cent was imposed on practically all imports, free and dutiable, from non-Empire countries and the excise taxes on automobiles were raised; the primary purpose of both measures was exchange

conservation. This was followed in July 1940 by the Government policy prohibiting the expenditure of United States funds for pleasure travel. The War Exchange Conservation Act of December 1940 aimed at aiding the exchange situation in three ways: (1) by restricting imports of non-essential commodities from non-sterling area countries, (2) by encouraging the expansion of export capacity, and (3) by encouraging imports from the United Kingdom. The importation from non-sterling countries of a wide range of commodities regarded as non-essential during the war was prohibited. Included in the prohibited list were many kinds of food, clothing, consumers' durable goods and other luxury articles. Under this measure the character of Canadian imports from the United States was altered but the resulting saving in exchange was only a fraction of the great expansion in imports essential for the war. The encouragement to exports was provided through tax concessions which might be extended to companies undertaking an expansion in export capacity. Imports from the United Kingdom were encouraged by removing or lowering the duty on a number of textiles and other commodities.

HYDE PARK AGREEMENT

These measures of exchange conservation taken in 1940, though very important, were insufficient to meet the great increase in Canada's United States dollar requirements, and the situation became increasingly serious in 1941. While encouragement was given to the expansion of exports which would produce United States dollars, to the production of gold, and to the promotion of the tourist trade, there were limits to the extent to which these more normal sources of exchange could be maintained in view of the increasing diversion of manpower and materials into war activities. New sources of receipts of United States dollars were necessary if Canada was to be able to continue for an indefinite period to purchase the great variety of United States commodities required for the prosecution of the war.

The new source of receipts worked out under the Hyde Park Agreement of April 1941 enabled Canada to concentrate her resources on the production of war goods. Canada and the United States were both net suppliers of munitions of war and it was agreed that each country should concentrate on the produc-

tion of types for which it was best adapted. This involved the production in Canada of certain kinds of munitions, strategic materials, aluminum and ships required by the United States.

As a result of these arrangements, a rapidly expanded programme of production was developed to meet the growing needs of the United States for materials and munitions. A crown company, War Supplies Limited, was set up to handle certain of the sales to the United States Government. The principal receipts of United States dollars occurred after 1941 as the volume of Canadian production increased. Receipts of United States dollars by this company were \$275 million U.S. in 1942, \$301 million U.S. in 1943 and \$314 million U.S. in 1944, after deducting refunds of advances on certain contracts and other adjustments by Canada. In 1945 receipts declined to \$189 million U.S.

OTHER U.S. GOVERNMENT EXPENDITURES IN CANADA

United States Government expenditures in Canada in connection with defence activities after Pearl Harbour also contributed substantially to the supply of exchange during the later years of the war. While it is difficult to identify all of the receipts of United States dollars originating from this source, they aggregate several hundred millions of dollars. These receipts of dollars first became appreciable in 1942. In 1943 they expanded rapidly, reaching their peak in that year, but continued to be very substantial in 1944. The construction of the Alaska Highway and other roads, chains of airfields, telephone lines, naval establishments and the Canol project were the principal activities giving rise to the expenditures. Maintenance and operation of the establishments with the personnel required contributed to sustaining expenditures after the original construction. A substantial portion of the capital expenditures of this type made by the United States Government was reimbursed to it by the Canadian Government in 1944.

SPECIAL RECEIPTS FROM THE UNITED KINGDOM

Another source of gold and United States dollars to which special reference should be made has been the receipts from the United Kingdom. As explained at greater length in the succeeding chapter, a part of the sterling area deficiency of Canadian dollars was met in this way. Total special receipts to the end of

1945 were \$458 million U.S., about half of which was received in 1940. In addition to these special receipts, additional amounts of gold and United States dollars were received from the United Kingdom as a result of inter-control adjustment of various items; moreover, the co-operation of the United Kingdom exchange control afforded Canada certain opportunities (of which examples are given on page 36 below) of using sterling instead of United States dollars in transactions with third countries.

CAPITAL INFLOWS

In the later years of the war the inflow of capital to Canada from the United States became an important source of exchange. The inflow took the form mainly of the purchase of Canadian securities by United States investors. The movement first became marked in 1942 and rose sharply in 1943 when gross sales of outstanding Canadian securities for United States dollars amounted to nearly \$200 million, or almost twice the total in 1942. While there was some falling off in 1944, the total for the year still exceeded \$100 million and in 1945 rose again to more than \$200 million.

Purchase of outstanding issues accounted for the greater part of the capital inflow although a number of new issues were also floated in the United States in connection with refinancing. Multiple currency issues guaranteed by the Dominion Government were exported in large quantities and provincial, municipal and corporation issues were also bought in substantial volume. With increased liquid reserves it was possible in 1943 to call several Dominion issues payable in U.S. currency with a par value of \$106 million in advance of their date of maturity; in addition parts of two other Dominion issues were refinanced in the United States. In 1943 a Canadian National Railways Government-Guaranteed issue aggregating \$57 millions payable in New York was called for redemption and New York pay Dominion issues aggregating \$40 million and \$115 million were called for redemption in 1945 and in January 1946 respectively.

Substantial capital inflows also rose from sales by Canadians of United States and other foreign securities. These were substantial throughout the war but particularly since 1943. In addition, inflows of United States capital for purposes of direct busi-

ness investment reached appreciable proportions in 1944 and 1945.

EXPORTS OF GRAIN AND OTHER COMMODITIES

The heavy American demand for Canadian grain which developed in 1943 with the shortage of grains for feed and industrial purposes in the United States provided another unusual source of United States funds of extraordinary size. Canada received approximately \$150 million U.S. from the sale of grain to the United States in 1943, in 1944 receipts were in the neighborhood of \$300 million and in 1945 around \$100 million. The magnitude of this non-recurrent source of dollars is brought into relief when it is recalled that receipts from exports of grain in 1944 considerably exceeded the total value of all merchandise exports to the United States in 1938. United States purchases of many other Canadian commodities also reached unprecedented levels in recent years, although the amounts are less than the sales of grain. In many other instances the demand is also temporary, resulting from wartime shortages.

RELAXATIONS IN EXCHANGE RESTRICTIONS

Because of the improved exchange position, it became possible in 1944 to reduce some of the restrictions upon the expenditure of United States dollars. The first step in this direction was taken in May 1944 when moderate amounts of United States dollars were made available to residents of Canada for travel for any purpose. The principal change introduced was to permit persons to buy up to \$75 in United States currency for travel for any purpose, but not more frequently than once every six months, or alternatively \$150 once every twelve months. One year later, in May 1945, further relaxations in the restrictions upon travel were introduced and since that time Canadians have been permitted to buy United States funds for any reasonable travel expenditures. The improved position also made it possible to introduce some flexibility in the control of capital exports in 1944 when certain types of application for United States dollars for the extension of Canadian business activity outside of Canada were approved.

The improved exchange position also made possible the removal of the restrictions on imports from the United States

and other non-sterling area countries which had been introduced by Parliament at the end of 1940 when the exchange situation was acute. The prohibitions on certain civilian imports from the United States contained in the War Exchange Conservation Act were removed by the repeal of the relevant sections of the Act in August 1944. Finally, in the budget introduced in October 1945, the War Exchange Tax was abolished.

IV. SURVEY OF STERLING POSITION AND POLICIES, 1939-1945

(a) *Summary of the Period as a Whole*

The balance of Canadian long-term indebtedness to the United Kingdom was substantially reduced between 1939 and 1945. Table III above shows that at the outbreak of war investments in Canada, including fixed investments, held in United Kingdom names (including those held by United Kingdom nominees on behalf of beneficial owners resident in other countries), amounted to approximately \$2,500 million at book values. Table VI (see page 30) shows the main wartime changes in the balance of Canadian indebtedness to the United Kingdom.

The principal reduction resulted from official repatriation of Canadian securities held in the United Kingdom which has amounted to \$703 million. In addition, other Canadian repurchases of Canadian securities held in Britain were substantial and there were appreciable redemptions of provincial, municipal and corporation securities maturing or called during the war. Other forms of private Canadian liabilities to the United Kingdom increased slightly on balance, representing mainly a small portion still unliquidated of the advances made by the British Government for the expansion of production of materials urgently needed for the war. Reductions in Canadian liabilities to the United Kingdom total \$958 million to the end of 1945. In addition, Canada's assets increased. In the first place, there has been the loan of \$700 million to the United Kingdom, of which \$561 million was outstanding at the end of 1945. When some other increases in Canadian assets in the United Kingdom, arising mainly from the temporary blocking of certain capital receipts made necessary by the shortage of dollars, are added to the total, the increase in Canadian claims against the United Kingdom is \$573 million, bringing the total ascertained reduction in the

TABLE VI

Wartime Changes in the Balance of Canadian Indebtedness to the United Kingdom to the end of 1945

(Millions of Canadian dollars)

	Sept. 15 to Dec. 31, 1939	1940	1941	1942	1943	1944	1945	Total to end of 1945
<i>Reductions in Canadian Liabilities to United Kingdom (minus sign indicates increase in Canadian liabilities):</i>								
Official Repatriation of Canadian Securities.....	75	137	188	296	4	2	1	703
Private Redemption of Canadian Securities	2	13	10	30	10	32	32	129
Other Repurchases of Canadian Securities	1	28	36	8	26	27	32	158
Other Indebtedness.....	-	-36	7	-13	4	3	3	-32
<i>Total Reduction in Canadian Liabilities.....</i>	<i>78</i>	<i>142</i>	<i>241</i>	<i>321</i>	<i>44</i>	<i>64</i>	<i>68</i>	<i>958</i>
<i>Increases in Canadian Assets in United Kingdom (minus sign indicates reduction in Canadian assets):</i>								
Loan to Government of the United Kingdom.....	-	-	-	700	-18	-57	-64	561
Other Assets.....	-1	-6	-1	6	7	8	-1	12
<i>Total Increase in Canadian Assets.....</i>	<i>-1</i>	<i>-6</i>	<i>-1</i>	<i>706</i>	<i>-11</i>	<i>-49</i>	<i>-65</i>	<i>573</i>
<i>Net Reduction in Balance of Canadian Indebtedness</i>	<i>77</i>	<i>136</i>	<i>240</i>	<i>1,027</i>	<i>33</i>	<i>15</i>	<i>3</i>	<i>1,531</i>

N.B. Excluded from above are fluctuations in cash balances, which would increase the figure for 1941 and reduce the figure for 1942 but would not affect the grand total. Also excluded are certain intergovernmental liabilities whose final amount and settlement have not yet been determined, e.g. the balances due from the United Kingdom to Canada with respect to the Commonwealth Air Training Plan and the interim advances made by Canada to the United Kingdom under the War Appropriation Act of 1945 as shown in Table VII, and the balances due from Canada to the United Kingdom with respect to Army capitulation payments.

balance of Canadian indebtedness in the United Kingdom to over \$1,500 million to the end of 1945. It should be noted that these figures are exclusive of certain intergovernmental liabilities whose final amount and method of settlement has not yet been determined.

(b) *Methods of Financing the Sterling Area Deficit of Canadian Dollars*

One of the primary objects of economic mobilization in Canada during the war was to increase Canadian production of food, raw materials and munitions urgently required overseas for the prosecution of the war. Most of this production was used in the United Kingdom and in the many theatres of the war overseas where British and Allied nations were engaged. Consequently exports of commodities from Canada on United Kingdom account expanded to unprecedented levels: these commodity movements reflect the pooling of resources and the distribution of production for the most effective prosecution of the war. The total expenditures of the sterling area on goods and services in Canada from the outbreak of war to the end of 1945 amounted to over \$10½ billion. Of this, about \$2½ billion was covered by ordinary commercial receipts and somewhat more than this amount by overseas military expenditures of the Canadian Government. The net deficiency amounted to approximately \$5½ billion and Table VII (see pages 32-33) shows the special methods used at various stages for financing it.

The sterling area deficiency of Canadian dollars during the war represents an accentuation of the outlines of the pre-war balance of payments. With the wartime expansion of Canadian production, the sterling area's pre-war current account shortage of Canadian dollars was greatly increased.

Before the war, the more moderate deficiency was covered, in effect, by transfers of United States dollars from the United Kingdom to Canada since Canada converted her surplus sterling into United States funds. At the outbreak of war it was necessary for the United Kingdom and other sterling area countries to introduce exchange control and husband their United States dollar resources. As the table shows, a relatively small proportion of the deficiency was covered in this way during the war; the

TABLE VII

Financing of Sterling Area Expenditures in Canada 1939 to 1945

(Millions of Canadian Dollars)

	1939	1940	1941	1942	1943	1944	1945 ¹	Total 1939-1945 Inclusive
1. Sterling Area Expenditures in Canada:								
Merchandise Exports from Canada.....	436	699	1,098	1,541	1,763	1,970	1,929	9,436
Tourist and Travel in Canada.....	9	6	3	2	1	2	2	25
Interest and Dividends to Canada.....	5	3	5	7	5	9	8	42
Freight and Shipping.....	43	76	119	127	148	169	151	833
War Services in Canada.....	—	20	74	130	128	128	81	561
All Other Current Payments to Canada..	9	18	22	19	21	29	38	156
Purchase or Sale (-) of Munitions Plants	—	100	157	58	-205	-2	}	-82
Withdrawal (-) of Working Capital.....	—	—	—	—	-190	—		
Total Sterling Area Expenditures in Canada as above.....	502	922	1,478	1,884	1,671	2,305	2,209	10,971
2. Sterling Area Receipts from Canada:								
(a) <i>Current Receipts:</i>								
Merchandise Imports into Canada.....	177	236	279	226	200	196	213	1,527
Tourist and Travel in Sterling Area.....	13	3	3	2	2	2	2	27
Interest and Dividends to Sterling Area...	80	76	68	51	52	56	56	439
Freight and Shipping.....	39	36	36	49	47	33	31	271
Canadian War Activities Overseas.....	—	29	97	191	499	1,085	696	2,597
All Other Current Requirements.....	17	23	33	38	50	56	46	263
Sub-Total.....	326	403	516	557	850	1,428	1,044	5,124

(b) *Other Methods of Financing
Sterling Area Expenditures:*

Canadian Official Repatriation of Securities.....	75	137	188	296	4	2	1	703
Canadian Private Repatriation of Securities.....	50	41	46	38	36	59	70	340
Sales of Gold and U. S. Dollars to Canada.....	2	248	—	23	143	55	33	504
Canadian Accumulation of Sterling Balances.....	—	82	728	-818	—	-4	1	- 11
Loan of \$700 mm. by Canada to United Kingdom.....	—	—	—	700	- 18	-57	-64	561
Billion Dollar Contribution by Canada.....	—	—	—	1,000	—	—	—	1,000
Canadian Mutual Aid to Sterling Area.....	—	—	—	—	503	834	838	2,175
Interim Advances to United Kingdom.....	—	—	—	—	—	—	164	164
All Other Capital Transactions, including errors and omissions ²	49	11	—	88 ²	153 ²	-12	122 ²	411 ²
<i>Total ((a) + (b))</i>	<i>502</i>	<i>922</i>	<i>1,478</i>	<i>1,884</i>	<i>1,671</i>	<i>2,305</i>	<i>2,209</i>	<i>10,971</i>

¹Subject to revision.

²Included in this item are currency settlements and other adjustments which were particularly large on balance in 1942, 1943 and 1945.

N.B. Excluded from above are certain intergovernmental liabilities whose final amount and settlement have not yet been determined. (See footnote to Table VI).

Source of above Balance of Payments Estimates: Dominion Bureau of Statistics.

amounts so received were, however, important in keeping Canada's balance of indebtedness to the United States within the limits set out in the previous chapter. Receipts of United States dollars were the equivalent of \$504 million Canadian up to the end of 1945.

By far the greater part of the sterling area deficiency of Canadian dollars was covered by special financial measures undertaken by the Dominion Government. The first of these was the repayment, in advance of maturity, of its obligations held in the United Kingdom. All Dominion Government, Dominion Government guaranteed and C.N.R. issues were repatriated, thus providing the United Kingdom with over \$700 million in the early years of the war. In addition to official repatriations there have been sales of vested Canadian securities in Canadian markets by the British Government. The security markets have also been the channel for other private purchases of Canadian securities held in the United Kingdom which have further contributed to the British supply of Canadian dollars.

The methods described were not sufficient to meet the British shortage of dollars in the first two years of the war, and to make up the balance, Canada accumulated substantial amounts of sterling during these years. In 1940 the accumulation of sterling by the Foreign Exchange Control Board and the Bank of Canada amounted to \$82 million. In 1941 this became the major source of financing when \$728 million was accumulated in the form of sterling balances; and the balances grew further in the early months of 1942. The Foreign Exchange Control Board was holding approximately \$1,000 million in sterling balances at the time that the disposition of these balances was provided for in the United Kingdom (War Financing) Act, March 1942. Approximately \$300 million was used by the Government for repatriation of securities and the balance was converted to an interest-free loan to the Government of the United Kingdom. Since 1942 the Foreign Exchange Control Board's sterling balances have been limited to those required for normal operations.

The sterling area deficiency of Canadian dollars in the last nine months of 1942 was met by \$1,000 million contributed to the United Kingdom in the spring of 1942; this was all disbursed

to purchase food, munitions and other war supplies in Canada before the end of 1942.

In the early months of 1943, before the introduction of the Mutual Aid programme, the sterling area deficiency of Canadian dollars was met by various special methods of financing. Gold and United States dollars equivalent to approximately \$165 million Canadian were sold by the United Kingdom to Canada at the end of 1942 and beginning of 1943. The Canadian Government took over, at a cost of \$205 million, the British interest in munitions plants which had been constructed in Canada with the aid of British funds in the early part of the war. About the same time there were cash repayments by Canada of working capital advanced by the United Kingdom in earlier periods to both government and private producers of munitions in Canada; these repayments amounted to \$190 million.

These special methods of financing were succeeded by the Mutual Aid programme which got under way during the latter half of 1943. Under the Mutual Aid Act, Canada provided food, munitions and other war supplies and war services to other Allied nations requiring this aid for the prosecution of the war. The first Mutual Aid appropriation in 1943 was for \$1,000 million and this was followed in 1944 by an additional appropriation for Mutual Aid of nearly \$800 million and in 1945 by an allotment out of the war appropriation of over \$650 million. Mutual Aid expenditures on account of sterling area countries to the end of August 1945 totalled \$2,175 million.

Following the termination of Mutual Aid, British expenditures on food were financed by interim advances under the War Appropriation Act of 1945. Such advances aggregated \$164 million outstanding at the end of 1945.

(c) Activities of the Foreign Exchange Control Board

The figures given in the preceding section show that the great bulk of the sterling area deficiency during the war years was financed by appropriation of public funds in Canada. The machinery of the Foreign Exchange Control Board was used as an instrument of financing only in the phase when the deficit was being covered through the accumulation of sterling. However, the administrative procedures of the Foreign Exchange

Control Board with regard to sterling and the sterling area have consistently been directed towards reducing the deficiency of Canadian dollars remaining to be covered out of public funds. Thus, there are no restrictions of any sort on the remittance of funds from Canada to the United Kingdom or other parts of the sterling area: remittances may be made for any purpose without formality or permit. The Foreign Exchange Control Board has collaborated with the exchange authorities of the United Kingdom to ensure that all Canadian dollars accruing to residents of the United Kingdom are placed at the disposal of the British exchange control and so made available to finance British purchases in Canada, thus reducing the use of Canadian public funds for this purpose.

Special procedures were also evolved by the Board to make sure that sterling or Canadian dollars (and not United States dollars) were used by Canadians in all payments to the sterling area and for goods produced in the sterling area, including sterling area goods purchased in third countries. In addition, the Board was able in certain cases to arrange to use sterling instead of United States funds for payments from Canada to countries outside the sterling area. For example, the Board made an arrangement with the Brazilian exchange authorities in 1941, which lasted until 1944, under which Canada paid for her imports from Brazil to the extent of 50 per cent in sterling and 50 per cent in United States funds, instead of 100 per cent in United States funds as would be the normal rule. Private trade with Brazil continued on a United States dollar basis, the above result being accomplished by an inter-control adjustment. As imports from Brazil were heavy during this period a considerable amount of sterling was used by Canada and a considerable amount of United States funds saved in this way. It was also possible to arrange for the use of sterling in payment of certain imports from other countries of Latin America. Moreover, support remittances to China, Finland, Greece and Italy have been covered in sterling. Under the British exchange control regulations the use of sterling by any country for payments outside the sterling area is normally prohibited and the transactions mentioned above have all taken place with the cooperation of the United Kingdom authorities.

Finally, since capital movements from the sterling area to Canada have the effect of increasing the sterling area deficiency of Canadian dollars, the Board has co-operated with the sterling area exchange control authorities in controlling such capital movements. Since early in 1942 capital payments from sterling area residents to Canadian residents have normally been allowed only when made to blocked sterling bank accounts in the names of the payees. Balances in such accounts are not convertible into Canadian dollars and may be used only for investment in sterling securities, the interest on which is, however, freely transferable to Canada. An exception was originally made for the first £100 of legacies or other capital payments from sterling area estates to Canadian beneficiaries and in August 1945 this was increased to £1,000. Arrangements also exist for allowing the transfer to Canada of small amounts of blocked sterling where the funds are urgently required by Canadian residents for maintenance purposes.

V. EXCHANGE FUND

(a) *Capital Resources of the Foreign Exchange Control Board*

The original capital resources at the disposal of the Board consisted of the Minister of Finance Special Exchange Fund Account established by virtue of the Exchange Fund Act of 1935. This amounted, on September 16, 1939, to \$83,876,974.41 and was entirely held in Canadian funds.

The capital resources available to the Board were subsequently increased, as required to finance acquisitions of foreign exchange, by advances from the Minister of Finance to the Special Exchange Fund Account. The first such advance, in an amount of \$325 million, was made on May 1, 1940, to enable the Board to pay for the gold and foreign exchange acquired under the Foreign Exchange Acquisition Order and the Exchange Fund Order. This advance was repaid on June 2, 1942. Aggregate advances and repayments of advances to the end of 1945 are shown below:

(In millions of dollars)

	Advances by Government	Repayment of advances	Advances out- standing at end of year
1940.....	325	—	325
1941.....	400	—	400
1942.....	72	622	175
1943.....	365	—	540
1944.....	245	—	785
1945.....	515	—	1,300

(b) *Revenues and Expenditures and Balance Sheet of the Exchange Fund Account*

Annexed hereto are statements of Revenues and Expenditures of the Exchange Fund Account covering the period from commencement of operations on September 16, 1939 to December 31, 1945 and of the Assets and Liabilities as at December 31, 1945. There is also annexed a detailed statement of the general operating costs of the Board. These statements recapitulate the information furnished to the Minister of Finance from year to year.

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

September 15, 1939 to December 31, 1940

REVENUE

From Turnover on Foreign Exchange.....	16,043,095.02	
From Transactions in Gold.....	432,775.55	
From Earnings on Investments and Foreign Balances.....	175,075.54	
	<hr/>	
Total Revenue.....		16,650,946.11

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	4,223,653.33	
Interest Paid on Loans from Dominion Government.....	2,008,539.69	
General Operating Costs.....	1,503,294.93	
	<hr/>	
Total Expenditure.....		7,735,487.95
		<hr/>
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		8,915,458.16

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

January 1, 1941 to December 31, 1941

REVENUE

From Turnover on Foreign Exchange.....	16,256,062.02	
From Transactions in Gold.....	8,503.42	
From Earnings on Investments and Foreign Balances.....	3,227,748.25	
From Profit on Sale of Investments.....	3,985.23	
	<hr/>	
Total Revenue.....		19,496,298.92

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	3,893,650.44	
Interest paid on Loans from Dominion Government.....	4,974,410.32	
Cost of Coin Shipments.....	10,089.48	
General Operating Costs.....	1,352,864.57	
	<hr/>	
Total Expenditure.....		10,231,014.81
		<hr/>
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		9,265,284.11

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

January 1, 1942 to December 31, 1942

REVENUE

From Turnover on Foreign Exchange.....	17,147,914.32	
From Transactions in Gold.....	— 65,255.49*	
From Earnings on Investments and Foreign Balances.....	3,021,515.40	
From Profit on Sale of Investments.....	650,159.59	
	<hr/>	
Total Revenue.....		20,754,333.82

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	4,087,001.23	
Interest paid on Loans from Dominion Government.....	3,943,074.18	
Cost of Temporary Financing Transactions undertaken with Bank of Canada.....	387,528.61	
Interest paid on Retirement Fund.....	1,220.57	
Cost of Coin Shipments.....	11,782.02	
General Operating Costs.....	1,098,573.72	
	<hr/>	
Total Expenditure.....		9,529,180.33
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		11,225,153.49

*This was a temporary book loss reversed in 1943.

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

January 1, 1943 to December 31, 1943

REVENUE

From Turnover on Foreign Exchange.....	18,068,453.66	
From Transactions in Gold.....	263,757.17	
From Earnings on Investments and Foreign Balances.....	807,155.98	
	<hr/>	
Total Revenue.....		19,139,366.81

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	4,805,309.80	
Interest paid on Loans from Dominion Government.....	4,028,059.36	
Cost of Temporary Financing Transactions undertaken with Bank of Canada.....	71.38	
Interest paid on Retirement Fund.....	1,261.35	
Cost of Coin Shipments.....	13,524.56	
General Operating Costs.....	876,630.14	
	<hr/>	
Total Expenditure.....		9,724,856.59
		<hr/>
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		9,414,510.22

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

January 1, 1944 to December 30, 1944

REVENUE

From Turnover on Foreign Exchange.....	16,869,105.51	
From Transactions in Gold.....	113,502.01	
From Earnings on Investments and Foreign Balances.....	1,413,102.24	
	<hr/>	
Total Revenue.....		18,395,709.76

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	4,572,745.38	
Interest paid on Loans from Dominion Government.....	6,374,316.94	
Cost of Temporary Financing Transactions undertaken with Bank of Canada.....	12,763.24	
Interest paid on Retirement Fund.....	1,267.27	
Cost of Coin Shipments.....	16,476.46	
General Operating Costs.....	758,143.33	
	<hr/>	
Total Expenditure.....		11,735,712.62
		<hr/>
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		6,659,997.14

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Revenue and Expenditure

January 1, 1945 to December 31, 1945

REVENUE

From Turnover on Foreign Exchange.....	14,360,432.50	
From Transactions in Gold.....	270,013.98	
From Earnings on Investments and Foreign Balances.....	2,655,160.68	
	<hr/>	
Total Revenue.....		17,285,607.16

EXPENDITURE

Commissions paid on purchases and sales of Foreign Exchange.....	4,372,857.99	
Interest paid on Loans from Dominion Government.....	8,470,068.48	
Interest paid on Retirement Fund.....	1,009.88	
Cost of Coin Shipments.....	24,900.54	
General Operating Costs.....	575,520.47	
	<hr/>	
Total Expenditure.....		13,444,357.36
Excess of Revenue over Expenditure, transferred to Reserve Fund.....		3,841,249.80

MINISTER OF FINANCE SPECIAL EXCHANGE FUND ACCOUNT

Statement of Assets and Liabilities

as at December 31st, 1945

ASSETS	
In Canadian Dollars.....	23,435,000.23
Cash on Deposit with Bank of Canada.....	1,009,767.27
Money Employed by Bank of Canada in Dominion of Canada Treasury Bills.....	20,825,000.00
Investment in Dominion- Guaranteed Securities..	1,600,232.96
In Foreign Exchange and Short-Term Securities of U.S.A. and U.K. Governments.....	1,021,977,056.15
In U.S.A. dollars.....	1,014,283,199.30
In sterling.....	7,543,413.56
In other currencies.....	150,443.29
In Gold.....	388,224,994.05
Sundry Accrued Assets	1,493,163.20
	<hr/>
Total Assets.....	1,435,130,213.63

LIABILITIES	
Capital and Reserves.....	133,198,627.33
Capital.....	83,876,974.41
Reserve Fund.....	49,321,652.92
Loan from Dominion Govt.	1,300,000,000.00
Accrued Interest Payable....	1,590,924.66
Sundry Accrued Liabilities	340,661.64
	<hr/>
Total Liabilities ..	1,435,130,213.63

GENERAL OPERATING COSTS OF FOREIGN EXCHANGE CONTROL BOARD

(cents omitted)

	Sept. 15- Dec. 31, 1939	1940	1941	1942	1943	1944	1945
1. Salaries.....	\$125,939	\$764,424	\$870,500	\$686,900	\$516,280	\$438,300	\$390,487
2. Cost of living bonus.....	—	—	14,521	35,402	38,605	34,013	32,118
3. Unemployment insurance.....	—	—	—	2,175	3,023	2,502	2,333
4. Travelling expenses.....	8,170	48,401	33,104	29,360	13,936	14,155	14,225
5. Postal censorship.....	—	—	166,637	149,259	155,867	136,900	40,000
6. Rentals, light, etc.....	6,886	50,620	68,702	63,044	64,374	55,326	14,691
7. Alterations to leased premises	—	20,094	20,524	3,407	Cr. 9,963	—	—
8. Office equipment including rentals and repairs.....	37,026	54,343	11,710	Cr. 4,545	Cr. 1,694	Cr. 3,047	Cr. 78
9. Stationery and printing.....	155,899	91,008	76,648	37,336	24,190	21,407	22,693
10. Telegrams and cables.....	13,590	23,859	9,826	8,678	6,769	5,712	8,548
11. Telephones.....	8,533	28,136	33,018	31,974	27,888	25,203	23,748
12. Postage.....	1,812	2,830	3,239	2,933	2,191	2,344	2,868
13. Express.....	31	70	4,768	2,963	4,355	5,282	8,329
14. Advertising.....	12,035	17,331	463	—	—	—	—
15. Enforcement costs.....	350	2,308	13,606	33,806	19,042	6,589	5,563
16. Sundries.....	4,971	24,627	25,590	15,875	11,762	13,452	10,088
TOTALS.....	\$375,243	\$1,128,051	\$1,352,864	\$1,098,573	\$876,623	\$758,143	\$575,520

NOTES TO STATEMENT OF GENERAL OPERATING COSTS

1. The staff of the Board at the dates indicated was as follows:

	Male	Female	Total
December 31, 1939.....	100	255	355
" " 31, 1940.....	224	325	549
" " 31, 1941.....	196	285	481
" " 31, 1942.....	111	217	328
" " 31, 1943.....	78	181	259
" " 31, 1944.....	60	169	229
" " 31, 1945.....	58	149	202

The high point in the Board's staff was 568 on February 28, 1941, after which it was possible to reduce it steadily due to improvements and simplifications effected in exchange control and increasing familiarity with exchange control policies and methods on the part of the banks and the public.

2. Cost of living bonus was paid in accordance with Orders in Council P.C. 6702 of August 26, 1941 and P.C. 1/4456 of May 31, 1943. The number of persons to whom cost of living bonus was paid was 328 at December 31, 1941; 233 at December 31, 1942; 223 at December 31, 1943; 203 at December 31, 1944; and 178 at December 31, 1945.

3. Eligible employees have been insured under the Unemployment Insurance Act since June 1, 1942.

4. This covers expenses of members of the staff who are required to travel in the course of their duties. In the earlier years a programme of visits by officers of the Board to banks and commercial firms operating under special permits from the Board was carried out for the purpose of discussing at first hand the problems arising in connection with exchange control and explaining the policies and procedures.

5. These represent payments to the Post Office and subsequently to the Department of National War Services in connection with the cost of examination of mail for foreign exchange control enforcement purposes. This expenditure ceased with the termination of the war.

6. During 1944 the cost of the Bank of Canada Annex which is occupied by the Board was amortized through rental payments made by the Board to the Bank of Canada and ownership of the building passed to the Board. At the end of 1945 the Board also occupied the following rented premises:

	Annual Rental \$
Ottawa, 268 Sparks St.	870
Vancouver, Marine Building	2,880
Toronto, 67 Yonge St.	3,912
Montreal, 201 Notre Dame St. W.	2,000
Windsor, Canada Bldg.	1,800

Total.....\$11,462

7. Extensive alterations were necessary in temporary rented premises occupied by the Board prior to the concentration of the Ottawa staff in the Bank of Canada Annex in 1942. In 1943 a recovery of \$10,000 was made for improvements made by the Board to space in 268 Sparks Street which was vacated the previous year.

8. Office equipment which became surplus to the Board's requirements with the reduction in staff was sold for \$6,446 in 1942, \$3,123 in 1943 and \$3,780 in 1944 principally to the Bank of Canada and the National War Finance Committee. 9. These include cost of paper, printing and distribution of Board licence and permit forms, instructions to authorized dealers, etc., the reductions from year to year being due largely to the simplification of procedures and the reduction in the size and number of forms required.

10. In the earlier stages of exchange control in particular, it was frequently necessary to communicate to authorized dealers by telegram instructions of an urgent nature.

11. The larger part of these expenditures was for the necessary daily communication between the Board in Ottawa and branches in Toronto and Montreal.

12. These cover registered and airmail, parcel post and branch office mail to which the franking privilege does not apply.

13. These represent shipping charges on sterling and U.S. coin and the distribution of Board forms and instructions to banks, etc.

14. In the early stages of exchange control a considerable amount of advertising was undertaken in order to familiarize the public with the regulations.

15. These represent mainly payments to counsel appointed by the Minister of Justice in connection with prosecutions for offences under the Foreign Exchange Control Order. The approximate amount of fines and forfeitures collected for such offences and credited to the Consolidated Revenue Fund were as follows: 1940—\$15,000; 1941—\$52,000; 1942—\$62,000; 1943—\$64,000; 1944—\$64,000; and 1945—\$48,000.

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